

# END OF LIFE PLANNING FOR EO'S<sup>1</sup>

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After many years of hard work, at their last meeting the directors of Save the Chipmunks (STC) decided that it was time to call it quits. The chipmunk population in many states had expanded to the point that no one today would consider chipmunks to be endangered. Further, it was becoming harder and harder to obtain contributions. Even those individuals who had been among the largest givers over the years were turning their attention to other projects. They asked their consultant to explore the options of what to do with the nonprofit and to report back to them at their next meeting. The consultant has asked you for advice. What will you tell him?

## In General.

When the members or directors of an exempt organization determine that it is no longer in their best interests to continue to operate as they have, there are several options open to them. If they want to continue in some fashion, it might be appropriate to expand the purposes -- for example, Save the Chipmunks might be expanded to a larger purpose: "Save the Rodents", or the purpose changed to something similar, such as "Save the Lemmings".

In most situations, however, when the directors decide that the corporation can no longer function in its current status, they do not want to resurrect it in a different form, but would prefer to be done with it. The options include merger with another exempt entity, dissolution and distribution of assets to one or more exempt entities, or transfer of control. Merger and dissolution involve many of the same steps, although dissolution is the most extreme change.

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<sup>1</sup> For additional information about this topic, including forms, please refer to CEB's *Advising California Nonprofit Corporations*, Chapter 18, Corporate Changes.

Both merger and dissolution of a corporation are accomplished pursuant to the state statute under which the corporation was incorporated. Dissolution in most states is relatively straightforward, although some states (like California) have made the process increasingly difficult. The following is a generalized discussion, focusing on California; it should be noted that there may be additional requirements in some states, which are not noted below. It should also be noted that there may be some differences, based on the type of exempt organization (for example, mutual benefit corporations are generally not subject to the review of the Attorney General unless they hold assets in charitable trust).

If a merger is possible, the corporate purpose may be able to be continued, albeit in a modified form. Some of the existing members (or directors) may serve in the resulting merged corporation, thus continuing their oversight over the assets. This may be desirable, especially if a stronger capital base is needed.

Another option would be to keep the organizations separate, but to have another group take over the control, by succeeding to a majority of the board positions or a majority of the membership. Alternatively, the assets might be distributed to another entity, keeping the current entity shell alive for use at a later date.

One item to note: If a corporation merges with another entity, the surviving entity will be the recipient of any bequests (Corp Code Sections 6022, 8022). There is no similar provision for a corporation's receiving a dissolving corporation's assets. Therefore, if the merging corporation has a number of bequests, merger should be strongly considered. On the other hand, in a merger, the acquiring entity receives all of the assets and liabilities of the merging corporation. Therefore, if the liabilities (including contingent liabilities) exceed the assets without some other corresponding benefit, dissolution and distribution of any remaining assets after payment of creditors might be preferable.

#### Sale of Assets.

If the corporation sells all or substantially all of its assets, it must first get approval of the directors, and members (if any) and other specified persons. In addition, for any public benefit or religious corporations, and any organization holding assets in charitable trust, written notice must be given to the California Attorney General at least 20 days before consummation of the transaction, unless a written waiver of notice is received. If a health facility is involved, then the rules become much more complicated and may include public hearings. See Corp Code Sections 5914(d) et seq.

#### Conversions.

In California there are five different types of corporations. Any corporation may convert into any other type of corporation by amending its articles. The corporation's board, its members, if any, and any other person whose approval is

required by the articles must approve the change. If the corporation has assets, the Attorney General must approve, in advance, any change of a public benefit into a mutual benefit, a business corporation, or a cooperative corporation. If no assets, the Attorney General must be given at least 20 days notice of the change. A change of a mutual benefit corporation into a religious or public benefit may require approval of the Commissioner of Corporations. See Corp Code Section 7813.5(b).

Having said all of that, it must be emphasized that assets subject to a charitable trust must continue to be used for the purpose for which they were given. Therefore, if the purpose of the corporation changes significantly, steps must be taken to assure this use. For example, at the time of the conversion, there may be a transfer of assets equal to the value of the corporation transferred to a similar nonprofit exempt organization. It should be noted further, that all assets of a public benefit corporation are considered by the Attorney General to be impressed with a charitable trust, subject to Attorney General's oversight.

#### Steps for Voluntary Dissolutions.

There are several steps that may need to be taken in order to dissolve a nonprofit corporation. These are as follows:

1. The directors of the corporation should vote to wind up and dissolve.
2. The members of the corporation, if any, should vote to wind up and dissolve.
3. An initial Certificate of Election to Wind Up and Dissolve may need to be signed by the president and secretary and filed with the Secretary of State's office (not required if the vote is by all members of a corporation with members or by all directors of a corporation without members, and a statement to that effect is added to the Certificate of Dissolution). This step is not required of most states.
4. In California, a Certificate of Tax Clearance used to be required from the Franchise Tax Board. As of September 29, 2006, this is no longer required. Rather, the Certificate of Dissolution, signed and verified by a majority of the directors, must state that: "A final franchise tax return, as described by Section 23332 of the Revenue and Taxation Code, has been or will be filed with the Franchise Tax Board, as required under Part 10.2 (commencing with Section 18401) of Division 2 of the Revenue and Taxation Code."

Note: This is a problem for churches and other entities that are not required to file with the FTB; there is no provision that excludes them from this requirement. I have discussed this with an attorney at the FTB, and he acknowledges that this is

an inconsistency that probably will need to be addressed at some point in clean up legislation. He suggested that a dissolving church could go ahead and make such a filing, but acknowledged that legally no filing can be required.

5. Preapproval from the IRS might be required before making fundamental changes. This is especially important if the organization is a private foundation.

6. Creditors must be notified, and all debts of the organization paid. If there are any contingent liabilities, notice of the dissolution should be given to each possible creditor and published in a newspaper of general circulation. This will require a claim to be filed within the requisite time period; if no claim is filed, the claim will be barred.

7. California law also requires that if the corporation is a public benefit or religious corporation, or holds assets in charitable trust, approval for the transfer of these assets be obtained from the California Attorney General/Registrar of Charitable Trusts. See discussion, below. All assets of a public benefit or religious corporation, and any other assets held in charitable trust must be distributed to another exempt organization. The organization(s) to receive the assets should have exempt purposes similar to the organization being dissolved.

8. Once the approval is obtained from the Attorney General, any remaining assets should actually be transferred.

9. When the assets are distributed, a Certificate of Dissolution which must be signed by the directors of the corporation is then filed with the Secretary of State's office (California law requires that this be accompanied by the response from the Attorney General). In many states, this is all that is required.

One should also note that in many states, the law currently applicable to nonprofit organizations may not be the law that was effective at the time the organization was formed. This may lead to confusion, both on the part of the applicant, and the state examiner, as to the exact requirements for dissolution.

10. Some states also require that there be a notice of dissolution published in a local newspaper of general circulation to complete the dissolution process.

11. If the corporation is required to file informational returns with the IRS, it must file a final return, as well as the final return with the FTB.

Additional note: Forms that may (but need not) be used for the dissolution process are now on the California Secretary of State's website.

### Steps for Mergers.

The steps to merge two entities, one or more of which are nonprofit corporations, are very similar:

1. The directors of each entity should vote to merge, and approve the merger agreement. This should be done in accordance with the terms of their respective organizational documents (bylaws) and the appropriate law that applies to each entity (interspecies mergers are now permitted).

2. The members, if any, of each entity should vote to merge, and approve the merger agreement. Again, this should be done in accordance with the terms of their respective organizational documents.

3. The merger agreement must then be signed by the president and secretary of each corporation and filed with the Secretary of State's office.

4. Again, a Certificate of Tax Clearance is no longer necessary. Rather, the surviving corporation automatically assumes any potential tax liability of the merged corporation.

5. Preapproval from the IRS might be required before making fundamental changes. This is especially important if the organization is a private foundation.

6. The California Attorney General must be notified of the merger. If, for a public benefit or religious corporation, the merger is with an entity other than another public benefit or religious corporation or similar foreign corporation, approval for the merger must also be obtained from the California Attorney General.

7. Once the notice is given and/or approval is obtained from the Attorney General, the merger agreement will be filed with the Secretary of State, and the merger will be completed.

Note: No notice to creditors is required in a merger; this is because any liabilities of the merged corporation are assumed by the surviving corporation as part of the merger.

Additional Note: Forms that may (but need not) be used for the merger process are now on the California Secretary of State's website.

### Approval From Attorney General.

Notice to and often approval from the Attorney General prior to dissolution or merger has been the law. However, it appears that many corporations were

ignoring this requirement. As a result, the law revised to require that a copy of the Attorney General's approval be attached to the Certificate of Dissolution. The net result is that the Registry of Charitable Trusts was inundated with the requests for approval, with no additional personnel to process the same. They have worked diligently to process these in a timely fashion, and have made great strides in addressing the issue; however, this may still be a roadblock to completing the filing within a specific timeline.

To obtain the approval, articles, bylaws, and exempt determination letters should be submitted for the dissolving corporation, and for every nonprofit corporation that will receive assets under the dissolution. A copy of the resolution of the board of the dissolving corporation should be included as well, along with current financial statements, if not already on file.

### Practical Questions to Ask

After listening to your recitation of this information, the consultant has determined that, to advise the board of Save the Chipmunks of the best solution, he needs to find out what, exactly the board wants, and what the current status of the corporation is. For example:

1. Do any of the members/directors wish to continue to operate a similar nonprofit corporation? If yes, the choices should include options for continued involvement, such as expanding the purpose, or merging with a nonprofit that would agree to this involvement (such as by adding one or more directors to their board, etc.).
2. Are there other nonprofits in existence with similar purposes that would be interested in merging, or with which Save the Chipmunks would want to merge?
3. Does the corporation have significant bequests? If yes, strongly consider merger over dissolution.
4. Does the corporation have significant liabilities, possibly in excess of assets (including contingent liabilities)? If so, dissolution might be the best option, with notice given to all creditors and potential creditors.
5. Is there an organization that would like to acquire the assets, perhaps by purchasing the same? This would be helpful if the liabilities are significant.
6. Are there specific 501(c)(3) organizations that the members or directors would like to see benefitted upon the dissolution of Save the Chipmunks? Note: The Attorney General will be concerned if significant assets will go to an organization with purposes unlike those of Save the Chipmunks.
7. Is there a time frame by which the board would like to see this accomplished? Are there ongoing expenses that need to be eliminated?

8. Is a health facility involved?
9. Is anyone going to object to the disappearance of Save the Chipmunks?
10. Is there an organization or other individuals that would like to take over the operation of Save the Chipmunks?
11. Is there dissension about this matter that might require the involvement of the court?

Once the board has thought through where they are now and where they really want to end up, then they will be able to make a decision of how to get there.